Comments Received
Between
August 3 - 15, 2005

BALLARD
PETROLEUM HOLDINGS LLC

RECEIVED
AUG 11 2005
D.N.R.C.

August 10, 2005

Mr. Monte Mason
Montana DNRC
P.O. Box 201601
Helena, MY 59620-1601

Re: Royalty Rate Review
School Trust Lands
State of Montana

Dear Mr. Mason:

The purpose of this letter is to comment on the recommendation by the Department of Natural Resources and Conservation to raise the royalty rate on state school trust lands from the current rates of 12.50% on gas and 13.00% on oil to 16.67% for both oil and gas.

I have been actively involved in the oil and gas business for more than twenty-eight years. Most of my career has been in the Rocky Mountain Region, primarily in Montana and Wyoming. The current increase in oil prices has been a boon to the industry but it should be pointed out that it has also been a benefit to the State and Federal coffers. However, the economics of some oil and gas exploration activities remain quite sensitive when compared to the amount of risk involved. When engaged in the lease acquisition phase of the exploration process, royalty rates are considered as they relate to the economics and the risk of the project.

Operators in certain areas of the State of Montana, such as Richland County, would be more likely to accept a minimal royalty rate increase. On the other hand, should the State elect to increase the royalty rates from the current rates to 16.67% in the majority of the remaining counties, I believe that the minerals owned by the school trust would either not be leased or be leased as a last resort. A higher royalty rate would not be competitive with the fee minerals as industry is currently acquiring oil and gas leases in most exploration prospects from fee mineral owners with a royalty rate of 12.50%.

I ask that you please consider not raising the royalty rates at this time or limiting the increase to a more competitive rate of 14.00%.

Thank you for your consideration. Should you wish to discuss this issue, please do not hesitate to contact me at 406.259.8790.

Sincerely,

Ballard Petroleum Holdings LLC

Dennis M. Campbell
Vice President - Land

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phone: 406 / 259-8790 • fax: 406 / 259-3884

devon

Devon Energy Production
Company, L.P.
20 N. Broadway, Suite 1500
Oklahoma City, OK 73102

Delivered Via Facsimile: (406) 444-2074

August 12, 2005

Mr. Monte G. Mason, Chief
Minerals Management Bureau
Trust Land Management Division
Department of Natural Resources & Conservation
P.O. Box 201601
Helena, MT 59620-1601

RE: Royalty Rate Review / Recommended Increase in State Oil and Gas Royalties

Dear Mr. Mason:

We at Devon Energy Production Company, L.P. (Devon) appreciate the opportunity to comment on the recommended increase in the royalty rates on state school trust lands from their current rates (12.5% for gas and 13.0% for oil) to 16.67% for both oil and gas. Devon holds a number of leases on state school trust lands, and we oppose the proposed increase in the royalty rates and disagree with the Department of Natural Resources and Conservation's *Royalty Rate Review, Comparison to Adjacent States, Analysis of Market and Industry Data* dated July 5, 2005 ("Review") for the following reasons:

We agree with the statement in the Review prepared by the Department of Natural Resources and Conservation (Department) that "...specific economics [of an oil and gas lease] vary with the depth, geology, reservoir characteristics and productivity of the target formations; the market price of the oil or gas produced, as well as development and operating costs associated with applicable recovery methods." (Page 10). However, we believe the Department failed to identify and consider the specific economics associated with oil and gas exploration and development on state lands in Montana. An increase in the state royalty rates together with these specific economics will have the effect of making state leases economically unattractive. Some of the specific economics that impact the economic viability of state oil and gas leases are:

1) State income tax. The Department compared the Montana state lease royalty rates to Wyoming's because the two states have oil and gas production from some of the same major geologic basins. However, the Department failed to consider that

Montana's state income tax (6.75%) is an additional cost burden on oil and gas leases. Wyoming does not have a state income tax. Montana receives income tax revenues from oil and gas production on state lands, and increasing the state royalty rates will make leasing state lands less economic. Note that, although Colorado's state income tax rate (4.63%) is considerably less than Montana's, Colorado has kept its royalty on state lands at 12.5%. Also, Alaska has a state income tax and has not changed its 12.5% state royalty rate for oil and gas. Montana's high income tax rate also drives up the costs of oil and gas operations by increasing the rates charged by service providers.

2) State severance taxes. The Department's Review failed to consider that Montana's state severance tax rates are much higher than those in Wyoming and North Dakota. The severance tax rate in Montana (9.26% to 15.06%) is as much as two and a half times the rate in Wyoming (6%), and as much as five times higher than North Dakota's severance tax rate ($0.1215/mcf—which would be approximately 3% on gas sold for $4/mcf). Montana receives considerably more severance tax revenue from oil and gas production (per unit of production) on state lands than either Wyoming or North Dakota, and increasing the state royalty rates will make leasing state lands less economic.

3) Total royalty interest. According to the Department's analysis, a lease is economically viable if it bears a total royalty interest (mineral owner and overriding royalties) between 16 and 20 percent. However, the Department's analysis further shows that the average overriding royalty burden on state leases is 6.72% for oil and 7.22% for gas. If the Board increases the state royalty rates to 16.67%, then the total royalty interest on state leases will be far greater than the 16%-20% range the Department predicts is tolerable. If the state royalty is increased, the leases will become less economic.

4) Federal royalty rates. The royalty rate on federal leases in Montana is 12.5%. This is significantly less than the 16.67% rate the Department has recommended on state lands, confirming that the recommended rate is higher than the going rate for oil and gas royalties in Montana. If the state royalty is increased to 16.67%, state leases will become less economic.

5) Private (fee) lands. Devon holds a number of fee mineral leases in Montana. Ninety-six percent (96%) of the private mineral lands on which we acquired oil and gas leases in 2004-2005 have a royalty rate of 12.5%. Thus, the going rate for oil and gas royalties in fee leases in Montana is 12.5%, which is significantly less than the 16%-19% range suggested in the Department's Review as well as the 16.67% rate it recommended on state lands. Again, if the state royalty is increased to 16.67%, state leases will become less economic.

6) Lower royalty rates in certain circumstances.

   a. In the Review the Department suggests that, because royalty rates are not triggered unless and until commercial production is actually discovered, there is no need for lower royalty rates in circumstances where there are higher risks associated with the lease (e.g. where the lease is far away from existing production or not subject to multiple bidders at auction). We believe the Department's conclusion ignores the economics associated with acquiring an oil and gas lease. Prior to acquiring a lease, a producer evaluates the economic viability of production on the lease lands. The factors considered include, among other things, the (1) total royalty interest; (2) total tax liability; (3) depth, geology, and reservoir characteristics and predicted productivity of the target formations; and (4) the likely exploration, development, and operating costs (including lease holding costs). Thus, oil and gas producers consider the economic impact of the total royalty interest *before* acquiring a lease, not after commercial production is discovered. The specific economics for each potential lease acquisition determine whether it is a good investment. If the state royalty rates are increased, producers with the capital to invest in responsible exploration and development will seriously evaluate the total royalty interest *before* acquiring a state lease—and an increased state royalty rate will reduce the likelihood that state leases will be acquired and developed.

   b. The lessee bears a significant risk when it invests capital in lease acquisition and exploration before knowing whether the lease will produce in paying quantities. There are many factors that increase these risks, including the distance between the lease lands and existing production. The state royalty rate structures in Wyoming and North Dakota are designed to encourage leasing and development on state lands with high risks. Increasing Montana's state royalty to a flat rate for all state lands does not take into account the higher risks associated with some state lands, and will result in some lands not being leased.

7) Exploration, development, and operating costs. The costs associated with being engaged in the oil and gas business in Montana are considerably higher than in other states. For example, Montana's environmental requirements take more time and cost more money than in other states. In fact, some environmental requirements are so cost prohibitive that they render leases valueless. Also, the environmental regulations change so frequently that it is very difficult to evaluate the costs of production in advance. For example, in the Powder River Basin the requirements for managing ground water produced in association with gas have changed many times over the past five years. There is also a significant risk of a lawsuit being filed by groups whose goal is to block oil and gas development. Litigation over development rights and governmental actions frequently delay oil and gas development for years.

Mr. Monte Mason
August 12, 2005
Royalty Rate Review

In summary, we believe it is misleading to justify an increase in Montana's state royalty rate by comparing it to the state royalty rates in Wyoming and North Dakota. There are many factors that make the cost of doing business in Montana much higher than it is in either of those states. While Wyoming's state royalty rate may be higher than Montana's current rate, the cost of doing business is less in Wyoming because it has no state income tax, its severance taxes are less than half those in Montana, and the costs and risks associated with exploration, development, and operating are considerably less. Also, most other states that have a state income tax have not raised their state royalty rates above 12.5%. Although North Dakota has a state income tax and has increased its state royalty rate, it is important to remember that Montana's severance tax rate is over five times higher than North Dakota's. We also believe the Department's conclusion that the 'going rate' for fee royalties on oil and gas in the state is 16%-19% is incorrect. Almost all of the fee mineral leases Devon acquired in the past eighteen months carry a 12.5% landowner's royalty—which we believe is the going rate for oil and gas royalties in Montana.

The costs and risks associated with exploration, development, and operating in Montana are considerably higher than in Wyoming, North Dakota, and other states in the region. Environmental requirements, development constraints, and the threat of litigation have rendered many leases valueless. While Devon has made a significant investment in oil and gas development in Montana, the ever-increasing cost of doing business there makes it a challenge to sustain and enlarge our operations. Like all companies in the private sector, we must earn a reasonable rate of return on our investments. The cumulative burden of costs associated with oil and gas exploration and development in Montana have eroded the economics to the extent that investment is discouraged. Given worldwide oil and gas investment opportunities, an increase in state oil and gas royalty rates will add to the already excessive cost burdens on investment in the state and result in a decline in leasing of state lands.

We request that the Department revise its Review, and that the Board not increase the current state royalty rates for oil and gas.

Sincerely,

Randall W. Maxey

Randall W. Maxey by MHS
Senior Regulatory Specialist

DONALD E. EPPERSON, SR.
6035 Mount Vista Road
Helena, Montana 59602
(406) 443-2511

August 11, 2005

By Fax: 444-2684

Monte Mason
Montana DNRC
P.O. Box 201601
Helena, MT 59620-1601

Dear Mr. Mason:

If I remember correctly, the last time annual rentals on state oil and gas leases was raised from \$1.00 to \$1.50 per acre, and it was done by the Legislature not the Land Board. Since the royalty (in my memory) has never been changed, are you sure the Land Board has the authority to change these rates?

Also, remember that the last time oil prices went up to \$40 per barrel, then shortly went down to \$10. They could do so again.

Sincerely,

Don Epperson Sr

Donald E. Epperson, Sr.

FIDELITY
Exploration & Production Company

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AUG 1 2 2005
D.N.R.C.

August 10, 2005

Montana Board of Land Commissioners
Montana DNRC
P.O. Box 201601
Helena, MT 59620-1601

Attn: Monte Mason

Re: State Royalty Rate

Ladies and Gentlemen:

Fidelity Exploration & Production Company (Fidelity), the largest producer of natural gas in Montana, greatly appreciates this opportunity to comment on your proposal to raise oil and gas royalty rates in future leasing of state minerals to a 1/6th royalty. Fidelity understands your desire to keep Montana competitive with Wyoming and North Dakota state royalty rates.

In regard to keeping Montana competitive and to realize the maximum value of the proposed royalty rate, Fidelity strongly encourages the Land Commissioners in their other official capacities to make Montana competitive with Wyoming and North Dakota in regulatory arena as well. Currently Montana's regulatory agencies, excluding the Montana Board of Oil and Gas Conservation, are not proactive in working with the oil and gas industry to develop mineral resources and protect environmental conditions.

For example, the Montana Board of Environmental Review has initiated rule making to re-examine the recently-passed numeric water quality standards, based upon a petition submitted by the Northern Plains Resource Council using flawed technical and regulatory justification. This rule making is not supported by any legitimate technical data demonstrating that the current numeric water quality standards are not working. The petition is based only on speculation and rhetoric.

Additionally, Fidelity has two Montana Pollutant Discharge Elimination System (MPDES) permits pending with the Montana Department of Environmental Quality (MDEQ). The first is the renewal application for an existing MPDES permit that was submitted to MDEQ in September 21, 2001. The second is Fidelity's MPDES permit application to **treat** produced water and discharge it. The treatment permit was submitted to MDEQ on March 11, 2004. Considering all of the debate surrounding Fidelity's produced water quality, a reasonable person would assume that the treatment permit would have been well received and would have been processed and approved in a timely fashion.

2585 Heartland Drive
Sheridan, WY 82801

Phone: 307.672.7111
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An MDU Resources Group, Inc. Company

Draft permits have been prepared for both applications and the permits have gone through public comment but are currently on hold.

Fidelity has made a significant financial investment in Montana. Our company is committed to conducting its operations in an environmentally responsible manner that realizes both short term and long term benefits for Montana. We are always available to discuss and seek solutions to the impediments that obstruct responsible oil and gas development in Montana.

Again, we appreciate this opportunity to comment. Should you have any questions or comments, please feel free to contact Bruce Williams or me at (307) 672-7111.

Respectfully submitted,
FIDELITY EXPLORATION & PRODUCTION COMPANY

Joseph C. Icenogle
Regulatory/Public Affairs Manager

xc: Governor Brian Schweitzer
State Capitol
P. O. Box 200801
Helena, MT 59602-0801

State Auditor John Morrison
840 Helena Ave.
Helena, MT 59601

State Attorney General Mike McGrath
P. O. Box 201401
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Secretary of State Brad Johnson
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Superintendent of Public Instruction Linda McCulloch
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August 9, 2005

Monte Mason
Montana DNRC
P.O. Box 201601
Helena, MT 59620-1601

Re: Proposed royalty increase on School Trust Lands

Dear Mr. Mason:

It is with a great deal of concern that I read of the DNRC considering increasing the royalty rates on oil and gas leases on all School Trust Lands. The purpose of my letter is to set out in detail the negative repercussions this action could have to the oil and gas industry and to the revenue stream to the State School fund.

As you are aware, prior to 1999 Montana had the dubious distinction of having the highest and most complicated oil and gas tax rates in the Rocky Mountains. Consequently, exploration activity in Montana languished to the point that, for a time, no drilling rigs were working within the State. Production and tax revenues were plummeting and the industry was all but extinguished. Fortunately, a bipartisan group of concerned legislators crafted in the 1999 legislature the monumental legislation known as the "tax competitiveness and simplification act." This act <u>lowered</u> taxes to compete with the surrounding States and <u>simplified</u> the tax structure regarding production taxes. Working with the Department of Revenue, this legislation was enacted and signed by the Governor. Almost immediately, exploration activity increased, and Montana is now one of the few states in the nation with <u>increasing</u> production revenues and <u>increasing</u> oil and gas volumes. This work was done in partnership with the State and the oil and gas industry as exemplified by the enclosed brochure. What a tremendous benefit this has been to all parties, including the approximately 1500 newly hired Montana workers!

The oil and gas industry has always been extremely competitive. Risk and capital costs can be staggering. Different States and Federal entities have competed for the tax revenues and heavy capital investments needed in the oil and gas industry. As an example, the Department of Interior, Bureau of Land Management oil and gas leases are set at a flat one-eighth (1/8) royalty. Additionally, the royalty rates in Colorado and Utah for State lands is also set at one-eighth (1/8). In North Dakota, State lands are leased at a one-eighth royalty rate for all lands within the State with the exception of lands within one mile of existing production, which are leased at a one-sixth (1/6) royalty. A large amount of the revenue derived by leasing these lands is obtained by the first year competitive bonus. By making the royalty rate attractive, competition is intense and lease bonuses remain in the millions of dollars a year.

Montana has numerous unproductive, but prospective, geologic basins which are in dire need of exploration and investment. (Judith Basin, Wheatland Basin, Crazy Mountain Basin, Bull Mountain Basin, to name a few). The last thing that the State of Montana should do is to set a prohibitively high royalty rate on School Trust Lands in these areas.

It is understandable that the DNRC wishes to receive its "fair share" of the pie during these times of high energy prices. However, sustained and predictable revenue should be the first priority. Boom and bust times have been a historic trend within the State to the detriment of many. By maintaining a competitive and predictable tax and royalty structure, we can help lessen the bumps along the way for years to come. Revenues and employment within the oil and gas industry could remain vibrant for the benefit of our citizens, schools and communities. I ask that you leave the royalty rates as they are for the benefit of all Montanans.

Very truly yours,

Thomas M. Hauptman

Thomas M. Hauptman

TMH:jb
Encs.

Cc: Brian Schweitzer, Governor
Linda McCulloch, Superintendent of Public Instruction
Brad Johnson, Secretary of State
Mike McGrath, Attorney General
John Morrison, State Auditor
John Bohlinger, Lt. Governor

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August 10, 2005

Mr. Monte Mason, Chief
Trust Land Management Division
Montana DNRC
P.O. Box 201601
Helena, MT 59620-1601

Re: Proposed Royalty Rate Increase on State School Trust Lands

Dear Monte:

I am Chip Youlden, CFO for Energy Consultants, LLC in Billings. Energy Consultants manages the Rocky Mountain Division assets of Helis Oil & Gas Company, L.L.C. Helis has a substantial and increasing oil and gas operating presence in the State of Montana.

We strongly oppose any disincentives to oil and gas exploration in Montana as it is a detriment to our business. It is our opinion that we, as producers, are partners with the State of Montana in the prudent development of natural resources. We pay the State production severance taxes on all produced oil and gas minerals and we pay the State royalties on State owned minerals. We see ourselves as partners with the State in that what is economically beneficial to us as producers is also an economic benefit to the State. Higher oil and gas prices help our bottom line and they also proportionately help improve State coffers via increased production tax and royalty revenues.

It has been shown that incentives work. Conversely, disincentives detract. In the late 1990's the Montana production severance tax rates were modified and reduced to provide incentives for new drilling and new horizontal well drilling. These incentives worked and the rig count and oil and gas activity improved directly as a result of the incentives. State royalty receipts and production tax receipts were substantially improved as a result of the incentives.

Increasing the State royalty by 33% from 12.5% to 16.67% is a disincentive and will have negative effect on the producers and their partner, the State of Montana.

Within the State of Montana our Company leases Federal, State and Fee minerals. Federal royalty rates are 12.5% like those of the State. Fee lease royalty rates are negotiated and vary from 12.5% up to 16.67%. In a competitive leasing environment, given uniform geologic and engineering considerations, our Company will look towards leasing from the lessor with the best terms including the lowest royalty rate. By increasing all State royalty rates to 16.67%, the State will be putting itself at a competitive disadvantage within its own borders.

In the spirit of "if it aint broke, don't fix it" please don't change the State royalty rate structure which has worked well for industry and for the State of Montana.

Sincerely,

Chip Youlden, CFO
Energy Consultants, LLC
Manager for Helis Oil & Gas Company, L.L.C. Western Division

c: Brian Schweitzer, Governor
John Morrison, State Auditor
Mike McGrath, Attorney General
Brad Johnson, Secretary of State
Linda McCulloch, Superintendent of Public Instruction